

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
INTERNATIONAL EQUITY REAL ESTATE**

September 16, 2005 October 17, 2005

This Policy is effective immediately upon adoption and supersedes all previous international real estate policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the International Equity Real Estate Investment Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with [international](#) equity real estate investment.

II. STRATEGIC OBJECTIVE

Generating superior risk-adjusted returns compared to the System's Direct Core Equity Real Estate Portfolio is the overriding objective of the Program. The investment selection shall be oriented to achieve the objectives of preservation of capital and diversification of risk. "International" is defined as being any geographic location other than the eight domestic - U.S. NCREIF (National Council of Real Estate Investment Fiduciaries) regions and the territory of Puerto Rico. The System shall make such investments under specified conditions and circumstances as described in this statement. The System's ability to commit large amounts of capital and long-term investment horizon give it a distinct advantage in investing in international real estate investments.

The expected rates of return shall be related to the countries selected for investment and their relative stages of development, targeted property types, relative control or liquidity or both that are associated with the real estate investment, and other structuring techniques used to mitigate taxes, if any.

III. PERFORMANCE OBJECTIVE

The performance of the investment Portfolios shall be compared to their ~~its~~ stated appropriate benchmarks, and target returns in excess of the minimum 5% overall real return objective for the U.S. Core Equity Real Estate Portfolio. These target returns may include appropriate country risk premiums specific to each country or region of investment.

IV. INVESTMENT APPROACHES AND PARAMETERS

A. Risks

The following factors shall be considered in assessing the attractiveness of international investing:

1. The tax treatment for the System by country and its potential impact on total return;
2. The difficulty in obtaining information regarding the behavior of private international real estate markets, and benchmarking performance;
3. Significant variance in risk and return attributes of real estate in developed countries compared with those associated with markets in developing countries; and
4. The use of leverage to minimize the tax burden often associated with international real estate investments and the direct impact this leverage has on the risk and required return of such investments.

There are unique risks associated with investment in international real estate. The primary ones are as follows:

1. The legal and regulatory environment;
2. Potential political and economic instability;
3. Currency exchange rate volatility;
4. Inconsistent building design and construction standards;
5. Tax policy and regulatory differences; and
6. Lack of reliable and consistent real estate market information and local employment and demographic data.

The mitigation of risks shall be achieved through techniques such as, but not limited to, the following:

1. Careful underwriting;
2. Legal and tax review; and
3. Retention of qualified experts familiar with the markets under consideration.

B. Diversification Guidelines

Given the specialized nature of international equity real estate investments, and the stated overall objective, it is not possible to mandate strict diversification guidelines for these investments. Capital allocations shall be primarily driven by market opportunities. The System shall seek to maintain a prudent level of diversification within and among such investments.

When investing in international real estate, prudent review and due diligence shall include review of political, economic, and social risks, as well as expropriation probabilities associated with the respective countries. In instances such as international commingled funds where the System may not have control over the investments, Staff will closely monitor such funds and report to the Investment Committee when such investments are at risk.

Care shall be given to avoid undue concentrations in developed or developing countries, or in any one particular country, region, or property type.

In those instances where investments are being considered in Emerging Markets, the Senior Investment Officer, (SIO), Real Estate shall have the discretion to permit real estate investments in emerging countries that obtain a favorable score, as approved by the Investment Committee, on CalPERS'the Wilshire Permissible Equity Market List with the exception of the capital market factors, as updated and reviewed annually. Emerging countries that do not score favorably on CalPERS'the Wilshire Permissible Equity Market List, but demonstrate compelling investment rationale will require Investment Committee approval. Emerging countries that are not reviewed in conjunction with CalPERS'the Wilshire Consulting Permissible Equity Market List, and are deemed to have sufficient investment merits, will require Investment Committee approval. Recognizing the ability of emerging countries to fall on and off CalPERS'the Permissible Equity Market List, investments will be approved for real estate investment according to the list in effect at the time of the proposed investment.

C. Investment Size

The size of international real estate investments shall depend on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. Additionally, investment size shall be appropriate to the projected risk/return level of the investments. However, in order to have some composite effect on the Portfolio, preference shall be given to investments with funding commitments of \$50 million or greater in size.

D. Structures

The Program shall be implemented through direct equity investments in international real estate (either 100% owned or through commingled vehicles), or through publicly traded international real estate securities, or some combination thereof. Equity, leveraged equity, and hybrid investment structures are available for direct investment in international real estate by the System.

E. Vehicles

The System shall consider a number of investment vehicles for investing internationally in real estate, including, but not limited to, the following:

1. Direct real estate equity investments in 100% owned assets;
2. Real estate equity joint ventures or other co-investment vehicles for real estate;

3. Indirect private real estate equity investments in commingled funds, private [Real Estate Investment Trusts \(REITs\)](#), limited partnerships, or other pooled investment vehicles;
4. Purchase of controlling or non-controlling interests of public or private international real estate operating companies;

In choosing specific investment vehicles for international real estate, the System shall consider, but not limit its options to, the following:

1. Proposed investment strategy;
2. Expected risk and return attributes of vehicles;
3. Potential exit strategies and liquidity;
4. Appropriate levels of control;
5. Monitoring costs and feasibility;
6. Potential diversification benefits;
7. Tax considerations;
8. Other incremental costs;
9. Governance and control of structure; and
10. Partners or co-investors.

F. Selection of Investment Management Firms

The System shall invest in international real estate investments on a direct or indirect basis through third-party investment advisors, general partners, operating company management teams, or other organizations with specific expertise in international real estate investments (collectively referred to as "Management Firms"). Management Firms shall provide expertise and experience locating, negotiating the acquisition, monitoring, and disposing of international real estate investments. Before selection, the System shall establish and document specific relevant criteria for each Management Firm to establish the basis upon which to make the selection.

Selection of management is critical to the success of the International Real Estate Program. The System shall approve Management Firms

based on their specific, successful and significant expertise (including the ability to mitigate risks identified in these markets) in locating, negotiating the acquisition, monitoring, and disposing of international real estate investments, in the particular, specific real estate market. Management Firms shall act in a fiduciary capacity and represent only the interests of the System in these transactions or, if the System is a co-investor, only the interests of the investor or shareholder group.

G. Asset Management

Management Firms shall represent the System's interests in asset management decisions, providing daily property management services, as expertise and organizational structure allow. The System shall give Management Firms appropriate Delegation of Authority while requiring that they provide adequate measures of accountability.

Appropriate financial and operational controls, as well as reporting requirements applied to direct domestic equity real estate investment, shall also apply to direct international real estate investment, to the extent consistent with the investment practices of local jurisdictions where appropriate. This shall include audited financial statements on a basis consistent with the System's accounting policy where appropriate. U.S.-dollar dominated accounting and performance information shall be required.

V. BENCHMARKS

The performance of the Portfolios shall be compared to U.S. equity real estate benchmarks, the NCREIF (National Council of Real Estate Investment Fiduciaries) and the WRESI (Wilshire Real Estate Securities Index) indices, or other benchmarks, if appropriate, and stated performance objectives. Where feasible, customized benchmarks shall also be developed for these investments (taking into account their specific risk attributes such as those described in Section IV, Investment Approaches and Parameters). Staff and the Board's Consultant will coordinate in establishing appropriate benchmarks.

VI. CURRENCY

In the interim, prior to implementation of the below, Staff and the Board's Consultant will coordinate appropriate strategies. In the longer term, the Real Estate Unit will periodically report all currency exposures to the CALPERS Global Fixed Income, International & Currency Unit (GFI). GFI may analyze currency exposures and recommend appropriate hedging strategies to the System's Chief Investment Officer and Senior Investment

Officer of Real Estate. The Real Estate Unit will coordinate with GFI to implement the approved strategies.

VII. GENERAL

This Policy is intended for investment in international direct equity real estate that includes property types such as, but not limited to, the following: office, retail, apartment, industrial, residential, hotel, and lodging resort properties including. ~~International real estate securities shall also be included as potential investments. International real estate investments shall be classified as a "specialized" real estate investment sector.~~

VII. ASSET ALLOCATION

~~As a percent of the total allocated Specialized Real Estate Portfolio, the international real estate sector shall range from 0 to 15%.~~

~~From time to time, the actual investment may fall out of the ranges prescribed by Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment to the System.~~

VIII. GLOSSARY OF TERMS

~~The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms. Definitions for key words used in this policy are located in the Real Estate Glossary of Terms which is included in the System's Master Glossary of Terms.~~

Approved by the Policy Subcommittee: April 24, 1998

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Asset Class Glossary: Real Estate
Policy: International Equity Real Estate
~~September 16, 2005~~ October 17, 2005

International

Any geographic location other than the eight domestic U.S. NCREIF regions and the territory of Puerto Rico. ~~The core portfolio may include investments internationally, limited to the North American countries of Canada and Mexico.~~

National Council of Real Estate Investment Fiduciaries Index (NCREIF)

A property level performance benchmark for institutionally owned real estate. The benchmark is composed of an income return, an appreciation return and a total return and is calculated on a quarterly basis.

Real Estate Investment Trust (REIT)

Refers to a private or publicly traded company which typically invests in income-producing properties and which qualifies as an REIT under Sections 856-860 of the Internal Revenue Code of 1986. As an REIT, a company must distribute to its shareholders at least 95 percent of its taxable income and is not subject to federal (and typically state) income tax to the extent income is distributed, among other requirements.

WRESI

Wilshire Real Estate Securities Index.